2001 Country Reports on Economic Policy and Trade Practices
Released by the Bureau of Economic and Business Affairs
U.S. Department of State, February 2002

EL SALVADOR

Key Economic Indicators

(Millions of U.S. dollars unless otherwise indicated)

	1999	2000	2001 1/
Income, Production and Employment:			
Nominal GDP	12,470.0	13,213.0	13,957.0
Real GDP Growth (pct)	3.4	2.0	2.0
GDP by Sector:			
Agriculture	1,297.0	1,271.0	1,290.9
Manufacturing	2,872.0	3,169.2	3,408.0
Services	7,439.0	7,460.4	7,872.8
Government	38.0	995.4	1,020.4
Per Capita GDP (US$)	2,026	2,105	2,183
Labor Force (000s) 2/	2,350.0	2,395.0	2,660.0
Unemployment Rate (pct) 3/	7.3	6.9	7.0
Money and Prices (Annual Percentage Growth):			
Money Supply Growth (M2)	9.0	8.0	9.1
Consumer Price Inflation	-1.0	4.3	3.5
Exchange Rate (Fixed Colon/US$)	8.75	8.75	8.75
Balance of Payments and Trade:			
Total Exports (FOB)	2,510.0	2,950.0	1,967.0
Exports to United States	1,576.0	1,927.0	1,271.9
Total Imports CIF	4,094.0	4,948.0	3,421.7
Imports from United States	2,109.0	2,450.0	1,661.2
Trade Balance	-1,584.0	-1,998.0	-1,454.7
Balance with United States	-533.0	-523.0	-389.3
External Public Debt	2,831.0	2,832.0	2,980.5
Fiscal Deficit/GDP (pct)	2.5	3.0	3.6
Debt Service Payments/GDP (pct)	3.0	2.5	3.5
Gold and Foreign Exchange Reserves 4/	1,969.0	1,890.0	1,805.0
Aid from United States 5/	46.8	58.0	103.2
Aid From All Other Sources 6/	223.6	189.0	313.5

1/ Annualized 2001 figures are Central Bank estimates. Trade figures are for January-August, 2001
2/ Estimate, Economically Active Population, i.e. all those over age 15.

3/ Figures do not include underemployment; 2001 rate is estimate.
4/ As of September 2001.
5/ Figures do not include military aid.
6/ Grants; including NGO assistance but not bilateral loan programs.

1. General Policy Framework

The Salvadoran government's two principal policies for financial stability and economic growth are the adoption of the U.S. dollar as legal tender and the pursuit of free trade agreements (FTAs). These polices are being implemented on the foundation of measures put in place during the last decade that mandated fiscal conservatism, monetary discipline, privatization, and rapid market and trade liberalization. The Monetary Integration Law, effective on January 1, 2001, made the U.S. dollar the principal legal currency and fixed its exchange rate with the Salvadoran colon at 8.75 to a dollar, the same rate that has been in place for seven years. Dollars are replacing colons, which are no longer being printed. All financial transactions, public and private, can now be done in dollars. President Francisco Flores has also aggressively sought new FTAs with the United States and other countries. In 2001, FTAs that El Salvador, along with other Central American countries, had reached with Mexico and with the Dominican Republic went into effect. The Salvadoran assembly also voted to approve an El Salvador-Chile FTA. Negotiations for FTAs with Canada and with Panama were initiated.

Economy's Performance in 2001

El Salvador's Central Reserve Bank is predicting an economic expansion of two percent in 2001, despite successive economic shocks, the most severe being the two devastating earthquakes early in the year that killed and injured thousands and left 1.5 million homeless. Additional economic shocks include: the slowdown in the United States, El Salvador's largest export market; a sharp drop in the price of coffee, the main agriculture export and an important source of rural employment; and a drought in the eastern part of the country. The largest source of foreign earnings in 2001 has been remittances from Salvadorans working outside the country, mostly in the United States, followed by exports by the so-called "maquila" assembly plants.

The Salvadoran economic expansion has been slowing for the last four years and has dropped precipitously from the six and seven percent annual growth rates achieved following the 1992 peace accords, which ended El Salvador's 12-year-long civil war. In the first quarter of 2001, the Salvadoran economy grew by 1.7 percent, followed by a 1.5 percent expansion in the second. During the first half of the year, the traditional agricultural sector contracted, while manufacturing grew by more than five percent. Construction also grew substantially, particularly in the second quarter.

When coffee is excluded, exports have increased by 7.4 percent for the period January-August 2001, according to the central bank. Of the total exports of $1.97 billion for the eight month period, the maquilas account for $1.1 billion. This represents a 5.3 percent growth over 2000, despite the slowing economy in the United States, where most of the Salvadoran maquila products are shipped. The Salvadoran Office of Investment Promotion reported that 14 companies had made commitments in 2001 to set up new operations in El Salvador, mostly maquila plants.

Exports of other nontraditional exports, excluding the maquilas, also increased in 2001, rising to $672 million, a 6.8 percent increase over the previous year. The value of traditional agricultural exports, on the other hand, decreased more than 40 percent, dragged down by the world price of coffee that has fallen to its lowest levels in 26 years. Coffee export earnings for January-August 2001 totaled $102 million, about $163 million less than for the same period in 2000.

Salvadoran imports also rose in 2001, increasing by 7.8 percent to total $3.4 billion for January-August 2001. Imports of intermediate goods rose the most, rising 15.8 percent. The trade deficit at the end of August was $1.45 billion. The central bank attributed the higher deficit to the slowdown in the United States and increased imports for earthquake reconstruction. Remittances from Salvadorans abroad, mostly in the United States, continued to rise in 2001, totaling $1.25 billion by the end of August, an 11.1 percent increase over the same period in 2000. The remittances have become an important source of funds for reconstruction and cover about 85 percent of the trade deficit, according to the central bank.

Domestic interest rates have declined, a development that is directly tied to dollarization since dollar lending rates have always been lower than colon rates. Energy prices have also moderated in 2001. Consumer price inflation is around 3 to 3.5 percent.

Fiscal Developments

The confidence that Salvadoran economic policy during the last decade has engendered among investors was seen in July when just months after the devastating earthquakes the government was able to sell $353.5 million in bonds in New York. The funds obtained from the sales of the 10-year, 8.6-percent interest rate bonds will be used to fund the government's budget and earthquake reconstruction.

Privatization continues to be a major part of Salvadoran fiscal policy. Since 1998, the government has privatized the state telephone company, the electricity distribution companies, the thermal power plants, and pension funds.

The 2001 $2.2 billion central government budget continued to shift spending toward social investments, with about one third of the funds dedicated to social development including health, education, and public works. The fiscal deficit is now about 3.6 percent of GDP. To help deal with the deficit, the Ministry of Finance plans to seek better tax collection, completion of privatization, and the implementation of measures to make the government more efficient. The 13 percent Value-Added Tax (VAT), which is applied to all goods and services both domestic and imported, accounts for about 55 percent of tax collections.

2. Exchange Rate Policy

On January 1, 2001, the Government of El Salvador enacted the Monetary Integration Law that made the U.S. dollar the nation's legal currency. The law mandated that for a transition period the dollar will circulate alongside the Salvadoran colon and fixed the exchange rate at 8.75 colons to the dollar. Within a period of no more than two years, the dollar is expected to completely replace the colon, which is no longer being printed. This law also required banks to convert depositors' colon-denominated accounts to dollar-denominated accounts and made the dollar the financial system's accounting unit. Businesses are free to sign contracts denominated in dollars, colons, and other major currencies.

3. Structural Policies

The United States is El Salvador's main trade partner. Imports from the United States have increased an average of 16 percent per year since 1993 and account for 50 to 65 percent of all Salvadoran imports. Key to this trend is the multi-year program, concluded in July 1999, to drastically lower tariffs. Under this program, tariffs for most capital goods and raw materials have been reduced to zero or one percent, and tariffs on intermediate and finished goods have been reduced to a maximum rate of 15 percent. Close to 80 percent of all Salvadoran imports consist of capital and intermediate products. El Salvador's 1998 environmental law is providing new opportunities for the sales of U.S. clean technology products.

The fastest growing trade/investment category has been the apparel and clothing maquila industry, in which companies from the United States and other countries ship cut cloth to plants in El Salvador where they are sewed into finished garments for reexport, principally to the United States. President Clinton signed into law in 2000 the Caribbean Basin Trade Partnership Act (CBTPA), which expanded the access to the U.S. market granted to El Salvador and other countries participating in the Caribbean Basin Initiative.

The government has substantially simplified customs procedures in recent years. A new system implemented in 1998, called "Teledespacho," allows importers and exporters to send their commercial invoices, bills of lading, and airway bills through an electronic link to the Salvadoran customs officer for processing. This system allows merchandise to clear customs seven days a week. The Salvadoran government also has an "Autoliquidation" process that allows assessment and payment of duties directly by the importer, without physical inspection in most cases.

El Salvador has a liberal privatization regime under which it has privatized the state owned telephone company (ANTEL), four electricity distribution and two thermal generating companies, and pension funds. All represent good opportunities for U.S. companies.

Prices are unregulated, with the exception of bus fares and utilities. These too are being deregulated. While fuel prices are not regulated, commercial margins on gasoline and diesel fuel are set by regulation at the import level and by the terms of an agreement between the government and the oil industry at the wholesale level. A commission to monitor the telecommunications and electric sectors (SIGET) has been established.

4. Debt Management Policies

El Salvador has traditionally pursued a conservative debt policy. External debt stood at $2.98 billion in August 2001. Almost 70 percent of this debt has been contracted with international financial institutions. The debt service in 2000 amounted to $341 million. El Salvador's prudent debt policies have been recognized by improved risk ratings on its official debt instruments by organizations such as Moody's and Standard and Poor's. In August 2001, Moody's rated El Salvador's foreign currency government bonds as Baa3 and its domestic currency bonds as Baa2, ratings that put the Salvadoran issues ahead of most of the rest of Latin America. Standard and Poor's, which rated fewer countries, gave El Salvador a BB+/Stable/B rating on January 22, 2001, a week after the first earthquake. This rating is ahead of many other Latin American countries.

In recent years, El Salvador has succeeded in obtaining diverse financing for various purposes from different international sources. These include the sales of bonds, Inter-American Development Bank and World Bank loans, bilateral development assistance, and grants and donations. In addition to the $353 million bond sale in July 2001, in August 1999 El Salvador successfully placed $150 million in Euro-Bonds. The Finance Minister has announced plans to consolidate and refinance outstanding government debt. Responding to the January and February 2001 earthquakes, donors gathered in Madrid in May where they pledged $1.3 billion for earthquake reconstruction and recovery. About $150 million of that amount was short-term.

5. Significant Barriers to U.S. Exports

El Salvador is a World Trade Organization (WTO) member and has implemented most of its Uruguay Round commitments on schedule. There are no legal barriers to U.S. exports of manufactured goods or bulk, non-agricultural products to El Salvador. Most U.S. goods face tariffs from zero to 15 percent. The range by category is zero to one percent for capital goods and raw materials, 5 to 10 percent for intermediate products, and generally 15 percent for finished goods. Higher tariffs of 15 to 30 percent are applied to automobiles, agricultural products, textiles and some luxury items.

In April 2000, the Salvadoran government announced high protective tariffs on certain grain and food imports to encourage domestic production. Under this new scheme, white and yellow corn are charged 20 percent ad valorem duties; paddy and milled rice, 40 percent; fluid milk and dairy products, 40 percent; sorghum, 40 percent; and pork, 40 percent. Otherwise, the government policy on basic grain tariffs (applied to imports from countries outside the Central American Common Market) is set by seasonal supply and demand conditions in the local market.

Generally, standards have not been a barrier for the importation of U.S. food products. Poultry is the notable exception. Since 1992, the government has imposed a zero tolerance requirement for several common avian diseases such as aviana denovirus, chicken anemia, and salmonella, effectively blocking all imports of U.S. poultry. The Ministry of Agriculture requires a salmonella-free certificate showing that the product has been approved by U.S. health authorities for public sale. These standards are applied in a discriminatory manner, since domestic producers are not subject to the same requirements. U.S. officials have met with Salvadoran authorities to discuss this issue, but to date there has been no success in getting the regulations changed.

The Salvadoran government also requires that rice shipments be accompanied with a U.S. Department of Agriculture certificate stating that the rice is free of Tilletia barclayana, although there is no practical treatment against T. barclayana. El Salvador failed to inform the WTO, under the Agreement on the Application of Sanitary and Phyto-Sanitary Measures, about these restrictions.

All fresh food, agricultural commodities, and live animals must be accompanied by a sanitary certificate. Basic grains and dairy products also must have import licenses. Authorities have not enforced the Spanish language labeling requirement.

The government is an active participant in the Free Trade Area of the Americas process. The country is a member of the Central American Common Market.

El Salvador officially promotes foreign investment in virtually all sectors of the economy. Foreign investment laws allow unlimited remittance of net profits, except for some services (hotels, restaurants, etc.) where the law allows 50 percent. No restrictions exist on establishing foreign banks or branches of foreign banks in El Salvador. The 2000 government procurement law applies to the central government, autonomous agencies, and municipalities. El Salvador is not a signatory to the WTO Agreement on Government Procurement.

6. Export Subsidies Policies

El Salvador offers a six percent rebate to exporters of non-traditional goods based on the FOB value of the export. Coffee and sugar can qualify for this rebate if they are shipped as a processed product. Products from the maquila assembly plants qualify if they meet the criteria of 30 percent national value added in the production progress. Firms operating in the free trade zones are not eligible for the rebate but enjoy a 10-year exemption from income tax as well as duty-free import privileges.

7. Protection of U.S. Intellectual Property

El Salvador has accepted the disciplines of the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and is a member of the World Intellectual Property Organization (WIPO). The current Intellectual Property Protection Law has been in effect since 1993. To help enforce the law the Office of the Attorney General in 1996 established a special unit for handling complaints about violations of intellectual property rights. The unit has conducted raids and made seizures of items such as pirated shoes, clothing, books, music recordings, videos, pharmaceuticals, and software.

El Salvador was removed from the Special 301 Watch List in July 1996. A September 2000 "out-of-cycle" U.S. Trade Representative's Watch List review of El Salvador determined that the country should not be put on the list again, but requested continued progress on bringing existing laws into compliance with the TRIPS agreement and called attention to the need for further action against software piracy.

In the 1993 law, patent terms were extended to 20 years from the filing date and the definition of what could be patented was broadened. Computer software is protected, as are trade secrets. Salvadoran authorities have drafted legal changes to make the IPR laws more TRIPS compliant. Legislation to make these legal changes may be taken up by the Legislative Assembly in 2001.

Copyrights are also protected by the 1993 law and the Salvadoran penal code was amended that same year to provide for criminal penalties for copyright violations. El Salvador has adhered to the Berne Convention. Despite certain positive developments, there are still many complaints about copyright piracy. Groups such as the International Intellectual Property Alliance say that software piracy continues to be a serious problem in El Salvador and that there are serious defects in the enforcement of civil and criminal laws intended to protect copyrights.

Trademarks are regulated by the Central American Convention for the Protection of Industrial Property. With international funding, the government is completing a comprehensive reorganization of its antiquated National Registry Office. The registration process has been simplified and computerized and significant progress is being made in reducing backlogs and adjudicating disputes. In trademark cases, there have been problems in getting enforcement of rulings ordering violators to cease using well known marks. El Salvador is signatory of the Geneva Phonograms, Paris Industrial Property and the Berne Artistic and Library Works Conventions.

8. Worker Rights

a. The Right of Association: The Salvadoran Constitution provides for the rights of workers and employers to form unions or associations, and the government generally has respected these rights. Some workers, however, have complained that the government impeded them from exercising their right of association. Union leaders asserted that the government and judges used excessive formalities to deny applications for legal standing to labor organizations. El Salvador has a small, organized labor sector with approximately 150 active unions, public employee associations, and peasant organizations, representing over 300,000 citizens, or 20 percent of the total work force. Unions and strikes are legal only in the private sector. Employees of autonomous public agencies may form unions but not strike.

b. *The Right to Organize and Bargain Collectively:* The constitution and the labor code provide for collective bargaining rights, but only to employees in the private sector and in autonomous government agencies. In fact, both private sector unions (by law) and public sector employee associations (in practice) use collective bargaining. Workers and the International Labor Organization report instances of employers using illegal pressure to discourage organizing, including the dismissal of labor activists and the maintenance of lists of workers who would not be hired because they had belonged to unions.

c. *Prohibition of Forced or Compulsory Labor:* The constitution prohibits forced or compulsory labor, except in the case of calamity and other instances specified by law. This provision is followed in practice.

d. Minimum Age for Employment of Children: The constitution prohibits the employment of children under the age of 14. Minors 14 or older may receive special Labor Ministry permission to work, but only where such employment is indispensable to the sustenance of the minor and his family. Child labor is not found in the industrial sector. Legal workers under the age of 18 have special additional rules governing conditions of work.

e. Acceptable Conditions of Work: The minimum wage is $4.80 (42 colones) per day for commercial, industrial, construction, and service employees. For general agricultural workers, it is $2.47 per day. Workers hired for harvests have a minimum wage of $2.70 day. Minimum wage for seasonal agriculture industry workers is $3.57. The law limits the workday to six hours for youths between 14 and 18 years of age and eight hours for adults, and it mandates premium pay for longer hours. The labor code sets a maximum normal workweek of 36 hours for youths and 44 hours for adults.

f. Rights in Sectors with U.S. Investment: U.S. investment in El Salvador has increased in recent years, especially in the energy and financial sectors. The labor laws apply equally to all sectors, including the maquilas (assembly or processing plants) in Free Trade Zones (FTZ). Most FTZ companies have accepted codes of conduct from their parent corporations or U.S. purchasers. These codes include worker rights protection clauses. There were credible reports of factories dismissing union organizers.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category	Amount	
Petroleum		(D)
Total Manufacturing		152
Food & Kindred Products	12	
Chemicals & Allied Products	42	
Primary & Fabricated Metals	(D)	

Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	(D)	
Transportation Equipment	0	
Other Manufacturing	(D)	
Wholesale Trade		28
Banking		(D)
Finance/Insurance/Real Estate		251
Services		10
Other Industries		99
TOTAL ALL INDUSTRIES		745

(D) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.